

AR56

REAL RESOURCES INC.

1997 Annual Report



REAL RESOURCES INC.

CONTENTS

Page 1	Highlights
Page 2	Message To Our Shareholders
Page 4	Statistical Review
Page 8	Operating Review
Page 13	Financial Review
Page 14	Management's Discussion and Analysis
Page 17	Financial Reports
Page 18	Consolidated Financial Statements
Page 28	Corporate Directory

ANNUAL MEETING

You are cordially invited to attend the Special and Annual Meeting of the Shareholders of Real Resources Inc. which will be held on May 21, 1998 at the Selkirk Conference Centre on the second floor at 555 - 4th Avenue S.W. Calgary, Alberta, at 3:00 p.m.

If unable to attend, shareholders are requested to complete and return the Proxy form to the Secretary of the Company.

HIGHLIGHTS

Financial

<i>[\$ thousands, except per share data]</i>	1997	1996	% Change
Net revenue	3,367	2,594	30
Funds from operations	1,423	1,545	[8]
Per share <i>[basic]</i>	0.10	0.13	[23]
Per share <i>[fully diluted]</i>	0.10	0.13	[23]
Net earnings	30	604	[95]
Per share <i>[basic]</i>	Nil	0.05	
Per share <i>[fully diluted]</i>	Nil	0.05	
Capital expenditures	4,725	3,488	35
Business acquisitions	18,816	—	
Long term debt	4,125	Nil	
Shareholders' equity	23,170	6,612	250
Common shares outstanding <i>[thousands]</i>			
Basic	32,542	13,031	150
Fully diluted	33,922	14,271	138

Operating

Production			
Natural gas <i>[mcf/d]</i>	665	852	[22]
Crude oil and NGLs <i>[bbl/d]</i>	357	223	60
Barrels of oil equivalent <i>[boe/d]</i>	424	308	38
Prices			
Natural gas <i>[\$/mcf]</i>	1.54	1.03	50
Crude oil and NGLs <i>[\$/bbl]</i>	25.47	28.48	[11]
Reserves			
Natural gas <i>[bcf]</i>			
Proved	2.2	4.5	[51]
Proved plus probable	2.8	5.0	[44]
Crude oil and NGLs <i>[mmbbls]</i>			
Proved	2.9	0.5	480
Proved plus probable	4.3	0.6	617
Land holdings			
Gross acres <i>[thousands]</i>	152	63	141
Net acres <i>[thousands]</i>	64	31	106
Wells drilled <i>[working interest]</i>			
Gross	13	12	8
Net	5.0	4.1	22

MESSAGE TO OUR SHAREHOLDERS

Real Resources Inc. [Real] completed its nineteenth year of existence in 1997. The Company was originally created by Renaissance Energy Ltd. in October of 1978. It became a public company in July 1989, when it was listed on The Alberta Stock Exchange. The activities of Real were managed by Renaissance until September 1994, when Renaissance sold its common shares to a group of individuals headed by Frans Burger, Martin Abbott and Dallas Droppo. The Company has gone through several metamorphoses in its history, the most dramatic occurring in 1997. The changes which took place in 1997 will have a profound effect on Real's future fortunes.

THE METAMORPHOSIS

Two corporate acquisitions were completed in 1997. The purchase of Flatland Resources Ltd. [Flatland] in January added a new focus area for Real in southeast Saskatchewan, encompassing 220 bbl/d of light medium oil and 13,041 gross [7,099 net] acres of undeveloped land. The second transaction, which occurred in December, was the purchase of Tri-Ex Oil & Gas Ltd. [Tri-Ex]. This purchase added another focus area for Real in east central Alberta comprising 1,100 bbl/d of medium oil production plus 39,965 gross [20,991 net] acres of undeveloped land. These two deals had the effect of increasing the size of the Company by a factor of five. Real now has a critical mass from which to survive and grow in an environment subject to tremendous volatility in oil and gas commodity prices and in equity markets.

The growth of Real also meant people changes. Our staff has more than doubled from 8 employees to 17. The restructuring that took place in the oil and gas industry during 1997 created a small pool of available people with successful track records in growing shareholder value. We have taken advantage of this opportunity to attract a number of these people to Real. The exploration group has doubled in size from 3 people to 6, and we have introduced a new dimension to our capabilities by adding an operations department of two office and four field staff. This core group of staff gives us the foundation to grow and to manage a much larger entity.

Although Real is now much larger in terms of assets and people, our primary goal remains the creation of shareholder value. Our strategy is to concentrate on finding and developing oil and gas reserves with a reserve life index in the eight-to-ten year range, which is a bit longer than our current reserve life. An emphasis will be placed on increasing the Company's exposure to natural gas. We are explorers, although selective strategic acquisitions will be pursued to complement the exploration program. Our exploration effort will involve extensive regional geological analysis, meticulous geophysical interpretation and advanced reservoir engineering, all of which utilize state of the art technology.

Our guiding principles are to:

- ☐ pursue oil and gas prospects in the Western Canadian Sedimentary Basin;
- ☐ assemble large land interests in diversified core areas and maintain large working interests and operatorship;
- ☐ generate prospects internally; and
- ☐ manage levels of debt.

By adhering to these principles, we will develop an inventory of exploration and development prospects that will have a meaningful impact on Real now and in the future.

1997 IN REVIEW

In 1997, average daily crude oil and natural gas liquids production rose 60% to 357 bbl/d from 223 bbl/d in 1996. Natural gas production fell by 22% to 665 mcf/d from 852 mcf/d. Total production averaged 424 boe/d in 1997, which was 38% higher than 1996 volumes of 308 boe/d. This increase in total production was primarily due to the acquisition of Flatland. We drilled 13 [5.0 net] wells during 1997 with a success rate of 60%.

Gross revenue was up 33% in 1997, totaling \$3.7 million compared to \$2.8 million in 1996. Funds from operations decreased 8% to \$1.4 million from \$1.5 million in 1996. On a per share basis, funds from operations amounted to \$0.10 in 1997, down from \$0.13 in 1996. Lower oil prices, higher operating costs, higher royalty costs and increased general and administrative costs contributed to the decline in funds flow. Net earnings decreased to nil from \$0.6 million in 1996, reflecting increased depletion charges.

Our average sale price for crude oil and natural gas liquids was \$25.47/bbl in 1997, down from \$28.48 in 1996. However, natural gas sold at a higher price of \$1.54/mcf versus \$1.03 in 1996. Softer crude oil and liquids prices caused revenue to lag production growth on a percentage basis.

WHAT'S NEXT

Entering 1998, the year promises to be one of the most active and exciting in our history. We have an inventory of low risk development projects that will require the investment of approximately 1/3 of our cash flow and provide the basis for our 1998 revenues. The remaining portion of our efforts will be directed towards exploration. We will build up our inventory of exploration projects and increase the size of our undeveloped land base while land prices are temporarily depressed due to low oil prices. We will place a strong emphasis on exploration for natural gas, concentrating on long life reserves in medium depth, multiple pay zone areas.

We anticipate that the market will be very strong for both corporate and asset acquisitions. Any acquisition that can add significant value, complements current programs, and will provide for low finding and development cost structures will be pursued.

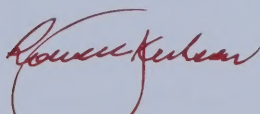
The above mentioned acquisitions, staff changes and application of our growth strategy created profound changes for Real in 1997. We look forward to reporting on the impact of these changes as 1998 progresses.

ACKNOWLEDGEMENTS

Real has undergone a dramatic change in the past year which could not have been accomplished without the hard work and dedication of our staff. We thank them for their efforts and for working together to create value for the Company's shareholders.

In closing, I would like to thank our Board of Directors for their wisdom and guidance throughout the year. I would also like to thank our shareholders for their support.

On behalf of the Board of Directors



Lowell E. Jackson
President & Chief Executive Officer
April 8, 1998

STATISTICAL REVIEW

RESERVES RECONCILIATION

	Proved	Probable	Total
Natural Gas [mmcf]			
January 1, 1997, opening balance	4,497.0	465.0	4,962.0
Production	[242.7]	—	[242.7]
Revisions	[1,609.3]	74.0	[1,535.3]
Business acquisitions	8.0	1.0	9.0
Property dispositions	[427.0]	—	[427.0]
December 31, 1997 closing balance	2,226.0	540.0	2,766.0

Crude Oil and NGLS [mbbls]			
January 1, 1997, opening balance	538.7	88.3	627.0
Production	[130.1]	—	[130.1]
Revisions	160.1	20.0	180.1
Additions	208.0	219.4	427.4
Business acquisitions	2,084.3	1,139.9	3,224.2
Property dispositions	—	[50.6]	[50.6]
December 31, 1997 closing balance	2,861.0	1,417.0	4,278.0

RESERVES BY PROPERTY*

[at December 31, 1997]	Proved	Probable	Total
Natural Gas [mmcf]			
Hays/Enchant	1,874.0	499.0	2,373.0
Minor properties	352.0	41.0	393.0
Total	2,226.0	540.0	2,766.0

Crude Oil and NGLS [mbbls]			
Sounding Lake	1,364.7	672.1	2,036.8
Hays/Enchant	577.9	253.9	831.8
Browning/Morrisview	308.6	50.7	359.3
Nelson Lake	160.5	178.3	338.8
Ashley Lake	152.9	85.0	237.9
Evi	174.0	21.3	195.3
Minor properties	122.4	155.7	278.1
Total	2,861.0	1,417.0	4,278.0

* Prepared by Paddock Lindstrom & Associates Ltd.

PRESENT WORTH OF FUTURE CASH FLOW

Discount [\$ 000s]	December 31, 1997*			December 31, 1996**		
	0%	15%	20%	0%	15%	20%
Proved	43,027	26,238	23,451	14,124	7,579	6,670
Probable	20,456	8,469	6,843	1,415	899	790
ARTC	5,480	3,800	3,486	1,551	1,185	1,102
Total	68,963	38,507	33,780	17,090	9,663	8,562

PRICING FORECAST*

	West Texas Intermediate US \$/bbl	Edmonton Reference Price Cdn \$/bbl	Corporate Average Natural Gas Price Cdn \$/mcf
1998	19.00	26.19	1.76
1999	20.00	27.20	1.87
2000	21.00	28.17	2.07
2001	22.00	29.53	2.20
2002	22.66	30.42	2.33

PRODUCTION BY AREA

	1997	1996
Natural Gas [mcf/d]		
Little Bow	484	561
Minor properties	181	291
Total	665	852

Crude Oil and NGLS [bbl/d]

Hays/Enchant	68	52
Browning/Morrisview	43	—
Ashley Lake	109	—
Evi	120	159
Minor Properties	17	12
Total	357	223

* Prepared by Paddock Lindstrom & Associates

** Prepared by Sproule Associates Limited

STATISTICAL REVIEW

ACREAGE SUMMARY

[at December 31, 1997] [acres]	Total		Undeveloped		Fair Market Value*
	Gross	Net	Gross	Net	
Alberta	69,224	27,341	58,787	23,797	\$ 1,527,511
Saskatchewan	53,183	23,259	49,124	22,269	1,503,590
Manitoba	29,046	13,625	28,222	13,534	335,113
Total	151,453	64,225	136,133	59,600	\$ 3,366,214
Average working interest		42.4%		43.8%	

DRILLING ACTIVITY

	1997		1996	
	Gross	Net	Gross	Net
Exploratory Wells				
Oil	1	0.2	3	0.8
Gas	-	-	1	0.5
Dry	5	1.7	5	1.4
Sub-total	6	1.9	9	2.7
Success rate		11%		48%
Development Wells				
Oil	5	2.3	2	0.9
Gas	-	-	-	-
Service	1	0.5	1	0.5
Dry	1	0.3	-	-
Sub-total	7	3.1	3	1.4
Success rate		90%		100%
Total Wells				
Oil	6	2.5	5	1.7
Gas	-	-	1	0.5
Service	1	0.5	1	0.5
Dry	6	2.0	5	1.4
Total	13	5.0	12	4.1
Success rate		60%		66%
Average working interest				
		38%		34%
Royalty interest wells	4	-	-	-

* Seaton-Jordan & Associates Ltd

NETBACKS

	Total	Natural	Oil and	Oil	
	[\$000s]	Gas	NGLS	Equivalent*	
	1997	\$/mcf	\$/bbl	\$/boe	1997
Oil and gas revenue	3,708	1.54	25.62	24.01	24.82
Royalties	[343]	[0.15]	[2.36]	[2.22]	[2.07]
Operating	[1,105]	[0.33]	[7.87]	[7.15]	[5.42]
Field netback	2,260	1.06	15.39	14.64	17.33
Other income	2	—	0.01	0.01	0.34
Administrative	[707]	[0.27]	[4.93]	[4.58]	[3.92]
Interest	[129]	[0.05]	[0.89]	[0.83]	—
Operating netback	1,426	0.74	9.58	9.24	13.75
Cash taxes	[3]	—	[0.02]	[0.02]	—
Corporate netback	1,423	0.74	9.56	9.22	13.75

FINDING AND ON-STREAM COSTS

[\$000s]	1997
Land	768
Seismic	789
Drilling and completion	2,504
Acquisitions	21,286
Total finding costs	25,347
Facilities	591
Total on-stream costs	25,938

Finding Cost per Unit [\$/boe]*

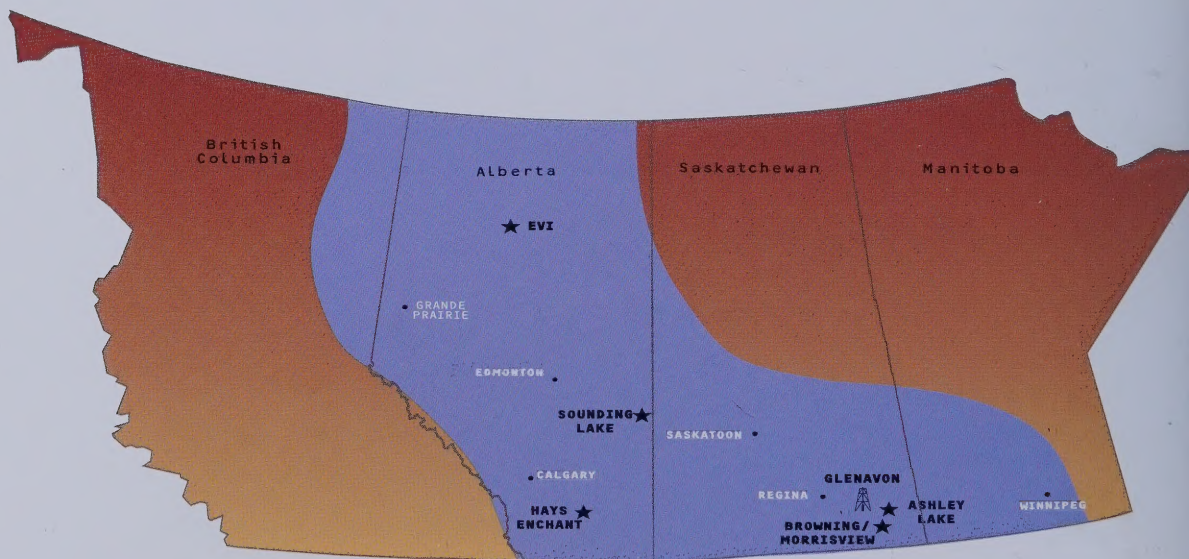
Proved	11.05
Proved plus probable	6.94
On-stream [\$/boe]	
Proved	11.31
Proved plus probable	7.10

* Oil equivalent 10mcf = 1 bbl

OPERATING REVIEW

EXPLORATION OVERVIEW

As a consequence of the Tri-Ex takeover, Real has expanded its exploration staff to include 4 senior geologists with proven track records [78 years combined experience] as well as 2 senior exploration technicians. Real will continue to use several consulting geophysicists with expertise in the Company's focused activity areas. This expansion is in keeping with the Company's philosophy of long term growth through focused exploration. Real has a complete, fully integrated information system, including a networked computerized geologic and well database, complete microfiche log coverage, as well as an in-house dedicated seismic 2-D and 3-D workstation. The exploration thrust will focus on rapidly building a prospect inventory parallel with current exploitation and development activities.



Two of our new explorationists are currently committed to working W5M and W6M in Alberta in pursuit of new high impact exploration targets based on regional stratigraphic mapping techniques, coupled with integrated seismic modeling. Natural gas will be a strong target for new exploration opportunities. Real has already acquired 38 sections of new Crown land on certain of these trends. Posting and acquiring new Crown lands will continue to be a primary objective over the next couple of years, with 20% of the 1998 budget allocated to new Crown land purchases.

Real will continue to be active in southeast Saskatchewan in 1998. In addition to its ongoing Mississippian horizontal drilling program, the Company has shot 650 kilometers of 2-D seismic, participated in the shooting of two 3-D seismic programs and acquired an interest in more than 50 sections of land in the Glenavon area. These aggressive moves furthered Real's strategy of developing a new exploration focus area in southeast Saskatchewan to take advantage of future land acquisition opportunities, including deep rights reversion. The Company is currently preparing to shoot an additional 3-D program to delineate an exciting Red River 2-D seismic lead for possible drilling later in 1998.

CORE AREAS OF ACTIVITY

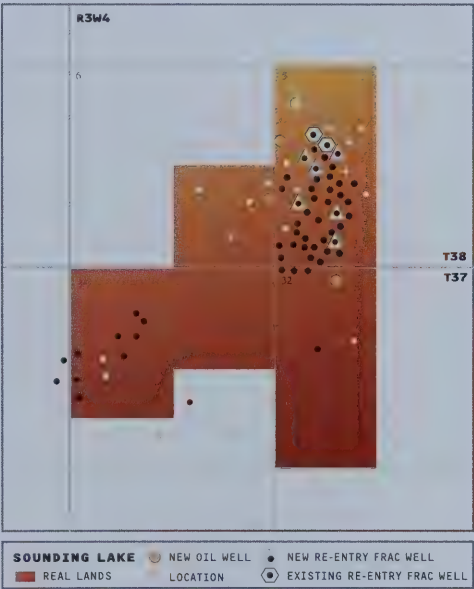
Real uses a multi-disciplinary technical approach to finding and developing hydrocarbon reservoirs. Regional geological, geophysical and engineering studies coupled with land and marketing considerations are used to assess our areas of interest. The application of state-of-the-art technology in petrophysical analysis, seismic and drilling/completion techniques reduces our risk and enhances our success. An overview of our core areas follows:

Sounding Lake Area

This area was the major producing area for Tri-Ex and is comprised of oil production from pools at Nelson Lake, Sounding Lake and Thompson Lake. Overall production from the area at the time of purchase was 1,055 bbl/d with gravities between 28 to 30 degrees API. Real has an average working interest of 56% in 1,560 acres [869 net] and 200 oil wells in the area.

The major producing pool in the area is located at Sounding Lake. The Company holds an average 68.5% working interest in the property. Production of 800 bbl/d is derived from the Dina formation, where the drilling depths average about 850 metres. This zone has been essentially developed. Well control and 3-D seismic indicate that four additional wells could be drilled on the west side of this pool. A reservoir study is currently being conducted on the pool to optimize both productivity and oil recovery. The goal for 1998 will be to stabilize production and increase pool recovery from this mature asset.

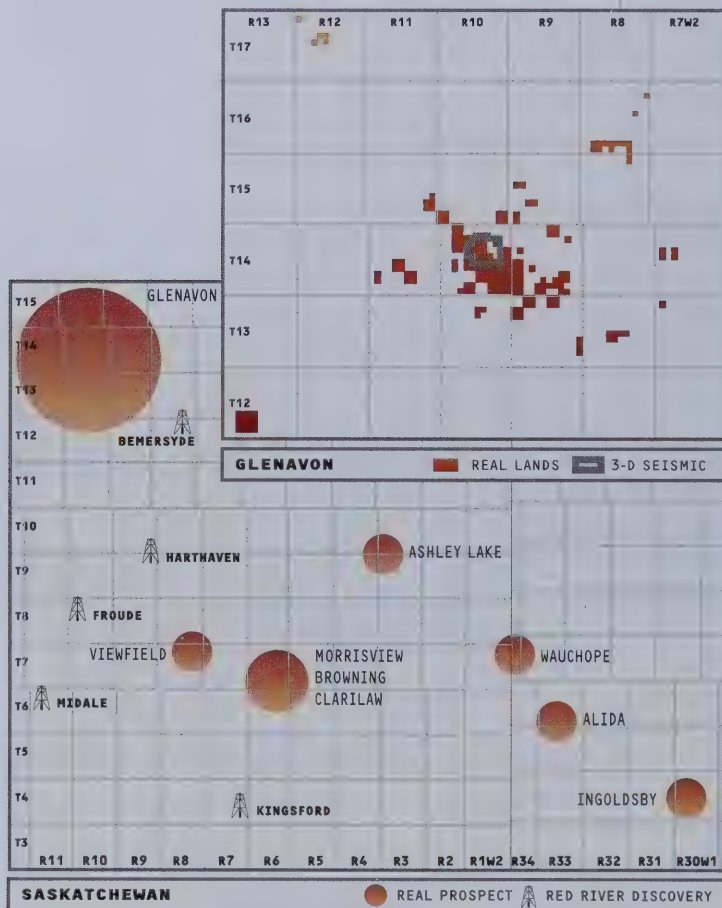
The upside to the Sounding Lake property exists in the Rex formation, which occurs behind pipe in the Dina oil producers. This zone occurs at average drilling depths of about 800 metres. Currently 3 wells are producing from the Rex at 180 [130 net] barrels of oil per day per well. Following a combination of drilling 10 wells and recompleting 10 Dina wells, a substantial increase in production is expected from the zone. The goal will be to fully develop the capability of the Rex pool this year. Existing well control combined with complete 3-D seismic coverage over the pool will allow for timely development. In addition, the facility infrastructure is already in place, which will also assist in rapid development of the Rex reserves.



OPERATING REVIEW

Southeast Saskatchewan

This was the producing area for Flatland. The acquisition of Flatland provided Real with an average working interest of 54% in 13,041 acres [7,099 net], 9 oil wells producing 220 bbl/d with an average gravity of 35 degrees API. The production is obtained from Mississippian oil pools located at Ashley Lake, Browning, Clarilaw and Morrisview. The Mississippian zones in these areas are found at drilling depths between 1,250 and 1,350 metres. In order to maximize the economics of development of these pools, a heavy emphasis is placed on 3-D seismic and horizontal drilling.



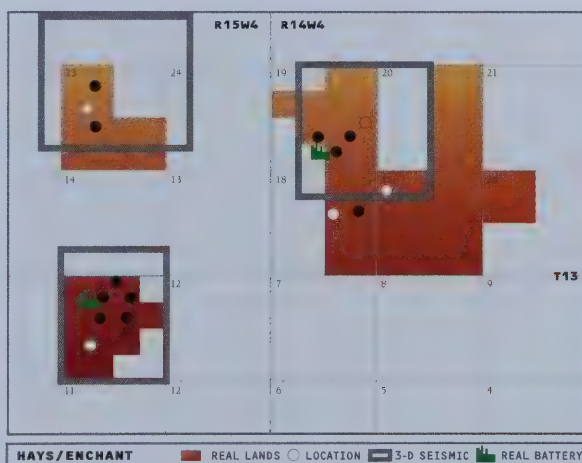
During the year, Real participated in drilling 5 horizontal oil wells, 1 vertical oil well and 4 dry holes in southeast Saskatchewan. The 1998 plan will be to maintain current production levels from the Mississippian through the drilling of 7 horizontal wells and 4 vertical wells. Further exploration activity in the Mississippian in southeast Saskatchewan will be de-emphasized in favor of an increased effort towards deeper Ordovician targets in the Glenavon area.

At Glenavon, 50 to 60 miles southeast of Regina, Real currently has an average working interest of 39% in over 35,000 acres of crown and freehold lands. This aggressive land position was influenced by a 650 km 2-D seismic program shot in 1996. A number of deep 2-D seismic leads have been defined and a 5.5 square mile 3-D seismic program will be shot in the second quarter of 1998 to delineate the strongest of these anomalies. Recent activity in the general area has resulted in several Ordovician Red River oil discoveries between Midale and Glenavon, including Bemersyde which is immediately adjacent to Real's acreage. North of the Bemersyde discovery, no wells have yet been drilled deep enough to penetrate the Ordovician. Real is currently planning to drill in the third quarter of 1998.

Hays/Enchant Area

Real targets multi-zone oil and gas prospects in this area and holds an average working interest of 27% in 4,720 acres [1,287 net] and 7 oil wells. The shallower Sawtooth zone occurs at drilling depths of about 970 metres. The deeper Arcs and Grotto zones occur at depths of approximately 1,325 and 1,345 metres respectively. Currently, the Company operates two oil pools producing from the Sawtooth formation and an Arcs oil pool. Real's production from the area averages 68 barrels of oil per day with an oil gravity of about 28 degrees API.

During the year, Real participated in drilling one water injection well in the area. The goal in 1998 will be to increase productive capability and oil recovery from the three pools operated by the Company through initiation of waterfloods. The standard practice in the area is to inject water into the oil pool to maintain and/or increase reservoir pressure resulting in a substantial increase in oil recovery from the pools. In the Company's case, waterflood implementation will increase oil reserves from about 200,000 to 750,000 barrels net.



Evi Area

This is a non-operated property in which Real holds an average working interest of 23% in 8,960 acres [2,075 net] and 9 oil wells. The Company's production from the area averages 120 bbl/d with a gravity of about 37 degrees API. Production originates from both the Gilwood and Granite Wash zones which are found at drilling depths of 1,575 and 1,590 metres respectively.

Real participated in the drilling of 2 dry holes during 1997.

The challenge in 1998 is to increase oil production from the area. Currently all production at Evi is processed at third party facilities for a fee. This approach is not only expensive but limits our ability to process production volumes. Stand alone facilities are planned to start up in 1998 in order to increase production, as will the drilling of 2 additional wells.

OPERATING REVIEW

DRILLING

Real's 1997 drilling program was the most active in its history. A total of 13 wells drilled resulted in 6 successful oil wells, 1 service well and 6 dry holes. In addition, 4 royalty interest wells were drilled at no cost to the Company. Thirty-nine percent of wells drilled were operated by Real. The Company achieved an overall success rate of 60% for the 1997 drilling program.

The goal for 1998 is to increase the number of wells drilled and the percent of wells operated by Real, boost the average working interest held in the wells and greatly improve the overall success rate of the drilling program.

PRODUCTION

Real increased average daily crude oil and natural gas liquids production to 357 bbl/d in 1997 compared to 223 bbl/d in 1996. The increase in oil production was mainly due to the purchase and development of properties acquired from Flatland. Natural gas production, meanwhile, decreased to 665 mcf/d in 1997 from 852 mcf/d in 1996 due to an influx of water and subsequent suspension of production at the Little Bow well. Overall, production on an oil equivalent basis increased 38% in 1997 versus 1996.

PRODUCT MARKETING

The Company's crude oil production is sold under short-term contracts at market sensitive prices. Historically, Real has not hedged its crude oil production and currently does not have a hedging program in place.

RESERVES

Year end proven plus probable reserves totaled 4,278 thousand barrels of crude oil and natural gas liquids and 2,766 million cubic feet of natural gas. On a barrel of oil equivalent basis, proven plus probable reserves were 4,555 thousand barrels, up 361% from the prior year. The acquisitions of Flatland and Tri-Ex contributed approximately 85% of the increase.

Proven reserve additions in 1997 replaced 1,485% of oil equivalent production. Total proven on-stream costs in 1997 were \$11.31/bbl of oil equivalent and \$7.10 on a proven plus probable basis.

FINANCIAL REVIEW

MANAGEMENT'S DISCUSSION AND ANALYSIS

OVERVIEW OF 1997

Two corporate acquisitions were completed in 1997. The purchase of Flatland in January added a new focus area for Real in southeast Saskatchewan, comprising 220 bbl/d of light medium oil and 13,041 gross [7,099 net] acres of undeveloped land. The second transaction, which occurred in December, was the purchase of Tri-Ex. This purchase added another focus area for Real in east central Alberta including 1,100 bbl/d of medium oil production plus 39,965 gross [20,991 net] acres of undeveloped land. These two deals had the effect of increasing the size of the Company by a factor of five. Real now has a critical mass from which to survive and grow in an environment subject to tremendous volatility in oil and gas commodity prices and in equity markets.

Revenues

Petroleum and natural gas revenue increased 33% to \$3,707,818 from \$2,788,035 in 1996 as a result of higher production volumes.

Oil production climbed 60% to 357 bbl/d in 1997 from 223 bbl/d in 1996. The increase in oil production was directly attributable to both the acquisition of Flatland and production from new wells drilled during the year. Natural gas production decreased 22% to 665 mcf/d from 852 mcf/d in 1996 due to the suspension of the Company's gas well at Little Bow.

The average oil price received by the Company was \$25.47/bbl, an 11% decrease from \$28.49 received in 1996. Strengthening natural gas prices boosted the Company's average gas price 50% to \$1.54 per mcf in 1997 from \$1.03 in 1996.

Royalties

Royalty expenses increased to \$562,985 from \$515,602 in 1996. As a percentage of gross revenue, royalties decreased to 15% in 1997 from 18% in 1996 as a result of the addition of lower royalty wells during the year.

The Alberta Royalty Tax Credit earned for 1997 was \$219,891 compared to \$283,007 for 1996. This decrease resulted from lower Crown royalties paid in Alberta due to a production decline at Evi and the suspension of production at Little Bow.

Other Income

Interest and other income decreased to \$2,010 from \$38,951 in 1996 due to less excess funds available for investment in short-term interest bearing deposits.

Operating Expenses

Operating expenses rose to \$1,104,787 from \$608,871 in 1996. On a unit of production basis, operating expenses increased 32% to \$7.15 per boe in 1997 from \$5.42 per boe in 1996. This rise resulted from the addition of higher operating cost oil properties acquired via the Flatland acquisition.

General and Administrative Expenses

General and administrative expenses totalled \$707,023 for 1997 compared with \$440,715 in 1996. On a unit of production basis, general and administrative expenses increased to \$4.58 per boe from \$3.92 per boe in 1996. The higher expenses are directly related to the addition of management and staff during 1996 and 1997 which were required by the growth in the operations of the Company. Real capitalized \$280,054 of indirect overhead expense in 1997 and \$76,186 in 1996.

Interest Expense

Interest expense for 1997 totaled \$128,687 compared with no interest costs in 1996. This increase reflected the financing of the acquisition of Flatland with bank debt.

Depletion and Depreciation

Depletion and depreciation increased in 1997 as a result of higher production levels and capital spending programs, including acquisitions. Total depletion and depreciation was \$1,305,204 for 1997 compared to \$604,483 for 1996. On a unit of production basis, depletion and depreciation increased to \$7.95 per boe from \$5.08 per boe in 1996.

Depletion and depreciation includes the Company's provision for future abandonment and site restoration costs. For 1997, this amount totaled \$44,824 compared to \$18,771 in 1996. The Company's total estimated future abandonment and site restoration liability increased to \$2,315,590 from \$254,200 in 1996, reflecting the larger number of properties owned by the Company.

In accordance with our accounting policy, Real applies a ceiling test to ensure the carrying value of its oil and gas properties does not exceed the estimated value of future net revenues from oil and gas reserves, using year end prices, less estimated future general and administrative expenses related to production of those reserves, financing costs and income taxes. As a result of the ceiling test performed at December 31, 1997, a cushion was calculated and no writedown was required.

Income Taxes

The Company's current tax expense of \$2,800 relates to large corporations tax. This marks the first year in which the taxable capital of the Company exceeds the minimum threshold at which the tax applies. All current income taxes have been deferred using the Company's accumulated tax pools. As shown in the following table, Real had \$22,001,000 of tax pools at December 31, 1997.

Summary of Tax Pools at December 31, 1997

	Available Balances	Maximum Annual Deductions
	000s	
Canadian Exploration Expense	\$ 5,240	100%
Canadian Development Expense	4,815	30%
Canadian Oil & Gas Property Expense	5,786	10%
Undepreciated Capital Costs	6,090	8-30%
Foreign Exploration & Development Expense	70	10%
Total	\$ 22,001	

Net Earnings and Cash Flow from Operations

Net earnings decreased to \$29,835 from \$604,372 in 1996. Net earnings per basic and fully diluted share decreased to \$0.00 from \$0.05 in 1996. Cash flow from operations decreased 8% to \$1,423,437 from the 1996 amount of \$1,544,805. Cash flow from operations per basic and fully diluted share decreased to \$0.10 from \$0.13 in 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Liquidity and Capital Resources

Real's 1997 capital expenditures and acquisitions were funded through a combination of cash flow from operations, equity and debt financing. In 1997, the Company's cash flow from operations was \$1,423,437 and net proceeds from equity issues were \$17,062,094. As at December 31, 1997, the Company had outstanding bank debt of \$4,125,000, including \$2,200,000 of debt assumed with the acquisition of Tri-Ex.

During 1997, the Company completed four separate equity issues. In September, a private placement of 1,032,000 common shares was closed on a flow through basis at a price of \$1.00 per share for gross proceeds of \$1,032,000. In October, the Company completed the private placement of 968,000 common shares on a flow through basis at a price of \$1.00 per share for gross proceeds of \$968,000. Another private placement of 953,000 common shares was completed on a flow through basis in November at a price of \$1.05 per share for gross proceeds of \$1,000,650. In December, Real issued 16,436,191 common shares to the shareholders of Tri-Ex as a result of the acquisition of the company. Additional shares were issued pursuant to the Company's stock option plan. During 1997, 122,000 common shares were issued under the plan for total proceeds of \$49,000.

The Company's credit facilities were replaced in January 1998 with a new credit facility in the amount of \$9,000,000. The facility bears interest at the bank's prime rate and is secured by demand fixed and floating charge debentures in the amount of \$50,000,000 conveying a first floating charge on all of the assets and undertaking of the Company. The facility is a demand revolving facility without fixed repayment terms and is subject to renewal from time to time at the bank's discretion.

Business Risks

Real is engaged in the exploration, development and production of crude oil and natural gas. The Company's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates and currency exchange rates. Operational risks includes competition, environmental factors, complex regulatory environments and safety concerns.

The Company minimizes its business risks by operating a large number of its properties. This enables the Company to control the timing, direction and costs related to exploration and development opportunities. The geological focus is on areas in which the geological prospects are well understood by management. Real closely follows all government regulations and has developed an emergency response plan that has been communicated to all field operations by management. The business risk is further minimized by maintaining a highly motivated and talented staff of petroleum and natural gas professionals.

Year 2000

During 1998, the Company will be undertaking a review to implement a plan to address the Year 2000 issues relating to its business, operations [including operating and financial systems] and corporate material. The review is not expected to add significant incremental costs as the Company does not utilize any in-house proprietary software or hardware systems.

The Company believes its primary exposure relates to its accounting system. The system is owned and maintained by a third party which has undertaken a project to ensure the software is Year 2000 compliant. There is no assurance the systems of other companies on which Real relies will be converted on a timely basis and any such failure to convert by another company would not have an adverse impact on the Company.

FINANCIAL REPORTS

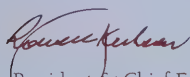
MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

To the Shareholders of Real Resources Inc.

The accompanying consolidated financial statements and all other financial information presented in this annual report are the responsibility of Real's management. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles.

Management has developed and maintains systems of internal accounting controls, policies and procedures in order to provide for the safeguarding of assets and preparation of relevant, reliable and timely financial information.

External auditors, appointed by the shareholders, have examined the consolidated financial statements. The Audit Committee has reviewed these statements with management and the auditors and has reported to the Board of Directors who have approved the consolidated financial statements.



President & Chief Executive Officer
Calgary, Alberta, Canada
March 20, 1998



Controller
& Chief Financial Officer

AUDITORS' REPORT

To the Shareholders of Real Resources Inc.

We have audited the consolidated balance sheets of Real Resources Inc. as at December 31, 1997 and 1996 and the consolidated statements of earnings and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statement present fairly, in all material respects, the financial position of the company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.



Chartered Accountants
March 20, 1998

Calgary, Alberta

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Balance Sheet

As at December 31, 1997 and 1996

	1997	1996
ASSETS		
Current Assets		
Cash	\$ 1 -	\$ 1,472,338
Accounts receivable	1,929,332	1,301,481
Notes receivable [note 3]	40,000	40,000
Prepaid expenses	39,762	8,373
	2,009,094	2,822,192
Notes Receivable [note 3]	80,000	120,000
Capital Assets [note 4]	29,000,972	5,502,775
	\$ 31,090,066	\$ 8,444,967

LIABILITIES

Current Liabilities		
Bank overdraft	\$ 120,610	\$ -
Accounts payable	2,981,375	1,352,473
	3,101,985	1,352,473
Long Term Debt [note 5]	4,125,000	-
Future Site Restoration	215,804	73,945
Deferred Income Taxes	477,200	406,873

SHAREHOLDERS' EQUITY

Capital stock [note 6]	23,568,304	7,039,738
Deficit	[398,227]	[428,062]
	23,170,077	6,611,676
	\$ 31,090,066	\$ 8,444,967

SIGNED ON BEHALF OF THE BOARD


Director


Director

Consolidated Statement of Earnings and Deficit

Years Ended December 31, 1997 and 1996

	1997	1996
Revenue		
Petroleum and natural gas	\$ 3,707,818	\$ 2,788,035
Royalties	[562,985]	[515,602]
Alberta Royalty Tax Credit	219,891	283,007
	3,364,724	2,555,440
Interest and other income	2,010	38,951
	3,366,734	2,594,391
Expenses		
Operating	1,104,787	608,871
General and administrative	707,023	440,715
Interest	128,687	—
Depletion and depreciation [note 4]	1,305,204	604,483
	3,245,701	1,654,069
Earnings before Income Taxes	121,033	940,322
Taxes		
Large corporations tax	2,800	—
Deferred income taxes [note 7]	88,398	335,950
	91,198	335,950
Net Earnings for the Year [note 8]	29,835	604,372
Deficit - Beginning of Year	[428,062]	[1,032,434]
Deficit - End of Year	\$ [398,227]	\$ [428,062]

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statement of Changes in Financial Position

Years Ended December 31, 1997 and 1996

	1997	1996
Operating Activities		
Net earnings for the year	\$ 29,835	\$ 604,372
Deferred income taxes	88,398	335,950
Depletion and depreciation	1,305,204	604,483
Funds provided from operations [note 8]	1,423,437	1,544,805
Net change in non-cash working capital	972,346	[819,324]
	2,395,783	725,481
Financing Activities		
Increase in long term debt	1,740,000	—
Notes receivable	40,000	[120,000]
Issuance of common shares, net of issuance costs	17,062,094	2,211,934
	18,842,094	2,091,934
Investing Activities		
Acquisition of capital assets	[4,711,881]	[3,487,856]
Disposition of petroleum and natural gas properties	767,798	627,988
Acquisition of entities	[18,816,383]	—
Net change in non-cash working capital related to investing activities	[57,394]	880,099
Site restoration costs incurred	[12,965]	[733]
	[22,830,825]	[1,980,502]
[Decrease] Increase in Cash During the Year	[1,592,948]	836,913
Cash - Beginning of Year	1,472,338	635,425
[Bank Overdraft] Cash - End of Year	\$ [120,610]	\$ 1,472,338

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 1997 and 1996

1. Summary of Significant Accounting Policies

Principles of consolidation

The consolidated financial statements include the accounts of the Company, together with the accounts of its wholly owned subsidiary.

Joint ventures

A significant portion of the Company's exploration, development and production activities are conducted jointly with others and accordingly, the accounts reflect only the Company's proportionate interest in these ventures.

Oil and gas properties

[a] Capitalized costs

The Company follows the full cost method of accounting for exploration and development expenditures whereby all costs related to the exploration for and the development of oil and gas reserves are capitalized. These costs include leasehold acquisition costs, geological and geophysical expenses, carrying charges of non-producing properties, costs of drilling both productive and non-productive wells, oil and gas production equipment and overhead charges directly related to exploration and development activities. Proceeds received from the disposal of properties are normally credited against accumulated costs unless this would result in a significant change in the depletion rate, in which case a gain or loss is computed and reflected in the earnings statement.

[b] Depletion and depreciation

Depletion of exploration and development costs and depreciation of production equipment are provided on the unit-of-production method based upon the estimated proven oil and gas reserves before royalties which are determined by independent petroleum engineers. For purposes of the depletion calculation, natural gas reserves and production are converted to an equivalent volume of crude oil on an energy equivalent basis of six mcf of gas to one barrel of oil.

[c] Ceiling test

The Company carries its oil and gas properties at the lower of capitalized cost and net recoverable value. Net recoverable value is future net revenues from proven reserves plus unproved properties at cost less impairment, if any. Future net revenues are determined using unit prices and production costs in effect at year end and include an allowance for future capital, site restoration and overhead costs, financing charges and income taxes that will be incurred in earning those revenues.

CONSOLIDATED FINANCIAL STATEMENTS

[d] Future site restoration

Future site restoration costs are charged as additional depletion expense on a unit of production basis. These costs are based on year end engineering estimates of the anticipated costs of site restoration. The accumulated charges, less actual costs incurred, are reflected on the balance sheet as a future site restoration provision.

[e] Measurement uncertainty

The amounts recorded for depletion and depreciation of oil and gas properties and the provision for future site restoration costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, crude oil and natural gas prices, future costs and other relevant assumptions. By their nature these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

Other capital assets

Depreciation of capital assets not related to oil and gas properties is provided using the diminishing balance method at rates varying from 20 percent to 30 percent.

Flow through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow through share arrangements are renounced to investors in accordance with tax legislation. Petroleum and natural gas properties and share capital are reduced by the estimated cost of the renounced tax deductions when the expenditures are incurred.

Earnings and funds from operations per share

Net earnings and funds from operations per common share are calculated using the weighted average number of common shares outstanding in the period. Fully diluted net earnings and funds from operations are calculated using the fully diluted weighted average number of common shares outstanding in the year unless the conversion of options are not dilutive.

Comparative figures

Certain 1996 figures have been reclassified for comparative purposes.

2. Acquisitions

Effective January 1, 1997, the Company acquired all of the outstanding shares of Flatland Resources Ltd. and Flatland Energy Inc. Both companies were private companies active in oil and gas exploration and development. The transaction was accounted for by the purchase method, and accordingly, the results of operations of Flatland Resources Ltd. and Flatland Energy Inc. have been included from the date of acquisition in the financial statements. The purchase price has been allocated to the net assets acquired based on the estimated fair market value:

Assets acquired:

Oil and gas properties	\$ 4,586,170
Working capital	326,553
Provision for future site restoration	[110,000]
Assumption of debt [includes bank indebtedness of \$150,231]	[335,231]
Net assets acquired, for cash	\$ 4,467,492

On January 31, 1997, Flatland Resources Ltd., Flatland Energy Inc. and the Company were amalgamated.

Effective December 29, 1997, the Company acquired all of the outstanding shares of Tri-Ex Oil & Gas Ltd. ["Tri-Ex"], a public company which was active in oil and gas exploration and development. The transaction was accounted for by the purchase method. The results of operations of Tri-Ex have been included from the date of acquisition in the financial statements. The purchase price has been allocated to the net assets acquired based on the estimated fair market value:

Net assets acquired:

Oil and gas properties	\$ 16,700,187
Other capital assets	79,736
Long term debt assumed	[2,200,000]
Working capital deficiency assumed and transaction costs [includes bank indebtedness of \$145,716]	[526,979]
	\$ 14,052,944

Consideration:

Issued 16,436,191 common shares to Tri-Ex shareholders	\$ 14,052,944
---	---------------

On January 9, 1998 the Company and Tri-Ex were amalgamated.

3. Notes Receivable

During 1996, the Company loaned \$80,000 to holding companies of each of two officers in order for each officer to purchase 100,000 common shares of the Company. The loans are non-interest bearing and are repayable in equal installments over four years commencing in 1997. The common shares purchased are pledged as security for the loans.

Balance, December 31, 1996	\$ 160,000
Installment received	[40,000]
Balance, December 31, 1997	120,000
Less: current portion - notes receivable	[40,000]
Long term portion - notes receivable	\$ 80,000

CONSOLIDATED FINANCIAL STATEMENTS

4. Capital Assets

	Cost	Accumulated depletion and depreciation	Net
December 31, 1997			
Oil and gas properties	\$ 31,215,062	\$ 2,360,381	\$ 28,854,681
Other capital assets	205,756	59,465	146,291
	<u>\$ 31,420,818</u>	<u>\$ 2,419,846</u>	<u>\$ 29,000,972</u>
December 31, 1996			
Oil and gas properties	\$ 6,596,602	\$ 1,132,720	\$ 5,463,882
Other capital assets	65,638	26,745	38,893
	<u>\$ 6,662,240</u>	<u>\$ 1,159,465</u>	<u>\$ 5,502,775</u>

During the year, \$44,824 [1996 - \$18,771] for site restoration was recorded as additional depletion and depreciation expense. During 1997, the Company capitalized \$280,054 [1996 - \$76,186] of indirect exploration overhead.

5. Long Term Debt

Long term debt reflects amounts advanced on the Company's demand revolving production and operating facilities with two Canadian chartered banks. Under the first facility, the Company can borrow up to \$4,500,000. Security is provided by a fixed and floating charge debenture over certain petroleum and natural gas properties in the amount of \$4,500,000 and a floating charge debenture in the amount of \$4,500,000 over all assets and undertakings of the Company. The facility bears interest at the bank's prime rate plus 1/2 of one percent.

The Company has a second credit facility in the amount of \$5,000,000. The facility includes a revolving demand loan of \$4,000,000 and a treasury risk line of \$1,000,000. Under this facility, advances are secured by a \$15,000,000 debenture providing for a fixed charge on certain of the Company's property and equipment and a floating charge over the entire undertaking of the Company. The revolving demand loan bears interest at the bank's prime rate plus 1/2 of one percent and the treasury risk line bears interest at standard rates as set from time to time by the bank.

In January 1998, the Company established a new credit facility in the amount of \$9,000,000 with a Canadian chartered bank. Under this demand revolving facility advances are secured by demand fixed and floating charge debentures in the amount of \$50,000,000 conveying a first floating charge on all of the assets and undertaking of the Company. The revolving demand loan bears interest at the bank's prime rate.

The demand revolving operating facility has no specific terms of repayment. The bank has indicated that while it reserves the right to request payment on demand, no principal payments are anticipated and the revolving credit facility will continue in the future provided the Company satisfies the conditions of the loan agreement.

6. Capital Stock

Authorized:

Unlimited number of each class of first, second, third and fourth preferred shares. No terms or conditions for the preferred shares have been set by the Board of Directors.

Unlimited number of common shares without par value.

Issued:

Common Shares	Number	\$
Balance, December 31, 1995	10,276,215	5,033,461
Issued for cash	2,600,000	2,230,002
Issued on exercise of options	155,000	53,500
Tax effect of flow through renouncement	—	[205,657]
Issuance costs	—	[71,568]
Balance, December 31, 1996	13,031,215	7,039,738
Issued on exercise of options	122,000	49,000
Issued for cash	2,953,000	3,000,650
Tax effect of flow through renouncement	—	[551,599]
Issuance costs, net of deferred taxes of \$18,071	—	[22,429]
Issued on acquisition of Tri-Ex Oil & Gas Ltd.	16,436,191	14,052,944
Balance, December 31, 1997	32,542,406	23,568,304

Flow through shares

Pursuant to flow through share agreements, the Company is committed to expend and renounce \$3,000,650 in qualified expenditures. As at December 31, 1997, the Company had incurred \$881,208 of expenditures and is committed to expend the balance of \$2,119,442 subsequent to year end.

Stock options

At December 31, 1997, options were granted and outstanding with respect to 1,380,000 common shares at prices from \$0.50 to \$1.20. The options expire at various dates ranging from September 23, 1999 to October 6, 2002. At December 31, 1996, outstanding stock options for common shares of the Company totaled 1,240,000 with exercise prices per share ranging from \$0.20 to \$1.05 and expiry dates ranging from September 21, 1999 to October 9, 2001.

Subsequent to year end:

- a) options were granted to employees, senior officers and directors of the Company with respect to 1,450,000 common shares at an exercise price of \$0.90. These options expire January 15, 2003;
- b) options were granted to employees with respect to 30,000 common shares at an exercise price of \$0.86. These options expire February 25, 2003;

CONSOLIDATED FINANCIAL STATEMENTS

- c] options to purchase 18,000 common shares at \$0.50 were exercised; and
- d] option to purchase 50,000 common shares at \$1.12 and options to purchase 150,000 common shares at \$1.05 were surrendered by a director for cancellation.

7. Income Taxes

The income tax provision differs from the result which would be obtained by applying the combined federal and provincial income tax rate to earnings before income taxes. The differences result from the following:

	1997	1996
Expected tax rate	44.6%	44.6%
Expected tax provision	\$ 54,005	\$ 419,384
Crown payments	231,606	383,969
Alberta Royalty Tax Credit	[98,115]	[283,007]
Resource allowance	[192,355]	[180,671]
Depletion and depreciation on assets with no tax base	103,905	—
Other	[10,648]	[3,725]
Deferred income taxes	\$ 88,398	\$ 335,950

Included in oil and gas properties are assets with a net book value of \$5,615,350 [1996 - \$958,000] which have no cost for income tax purposes.

8. Per Share Information

	1997	1996
Net earnings		
Per share basic	\$ 0.00	\$ 0.05
Per share fully diluted	\$ 0.00	\$ 0.05
Funds from operations		
Per share basic	\$ 0.10	\$ 0.13
Per share fully diluted	\$ 0.10	\$ 0.13
Weighted average number of common shares outstanding		
Basic	13,815,378	11,523,715
Fully diluted	15,072,632	12,223,850
Common shares outstanding at year end		
Basic	32,542,406	13,031,215
Fully diluted	33,922,406	14,271,215

Funds from operations is based on net earnings before depletion and depreciation and deferred income taxes.

9. Related Party Transactions

A director of the Company is a partner of a law firm which was paid \$127,600 [1996 - \$48,983] for legal services.

10. Financial Instruments

The carrying values of cash, accounts receivable, notes receivable, bank overdraft and accounts payable approximate their fair values due to the relatively short period to maturity. The fair value of long term debt approximates its carrying value as it bears interest at floating rates.

11. Commitments and Contracts

Joint venture agreement

Pursuant to a joint venture agreement effective January 1, 1995, the Company has committed to spend \$5,656,021 to explore, drill and complete wells on certain oil and gas properties acquired under the agreement. Under the agreement, the Company's joint venture partner has spent \$2,828,010 to acquire the rights to the oil and gas properties. The expenditure of the exploration and drilling costs will cause the Company to earn a 70 percent interest in these properties. As at December 31, 1997, the Company has incurred \$3,574,863 of expenditures pursuant to this joint venture agreement.

The joint venture agreement provides for equalization of payments between the joint venture partners at the termination of the joint venture period. The amount of the equalization payment payable by the Company based on expenditures to December 31, 1997 is \$552,249. As the Company incurs further expenditures under the joint venture agreement, the amount of the equalization payment will be reduced.

Operating leases

Effective February 15, 1998, the Company cancelled a lease for office space and entered into a new lease for office space. Future minimum lease payments under operating leases for office space, including estimated operating costs at February 15, 1998 were as follows:

Year ended December 31,

1998	\$ 257,553
1999	315,333
2000	324,624
2001	275,083
2002	276,941
	\$ 1,449,534

CORPORATE DIRECTORY

CORPORATE OFFICE

Suite 700
555 Fourth Avenue S.W.
Calgary, Alberta
T2P 3E7
Telephone: [403] 262-9077
Facsimile: [403] 262-6403

DIRECTORS

Lowell E. Jackson

Calgary, Alberta

Martin G. Abbott

Calgary, Alberta

Frans Burger

Calgary, Alberta

Dallas L. Droppo

Calgary, Alberta

OFFICERS

Lowell E. Jackson, P.Eng.

President & Chief Executive Officer

Gordie D. Crowell, P.Geol

Vice President Exploration

Ken P. Murphy, P.Land

Vice President Land and Corporate Development

Lesley L.N. Miller, C.A.

Controller & Chief Financial Officer

LEGAL COUNSEL

BLAKE, CASSELS & GRAYDON

BANKER

BANK OF MONTREAL

REGISTRAR AND TRANSFER AGENT

MONTREAL TRUST COMPANY OF CANADA

AUDITORS

KPMG, CHARTERED ACCOUNTANTS

RESERVE CONSULTANTS

PADDOCK LINDSTROM & ASSOCIATES LTD.

STOCK EXCHANGE

THE TORONTO STOCK EXCHANGE

Trading Symbol: **RER**

ABBREVIATIONS

bbls	barrels
mbbls	thousand barrels
bbl/d	barrels of oil per day
mcf	thousand cubic feet
mcf/d	thousand cubic feet per day
mmcf	million cubic feet
boe	barrels of oil equivalent where natural gas is equated to oil using 10 mcf = 1 barrel of oil
mboe	thousand barrels of oil equivalent
NGL	natural gas liquids

SHARE TRADING SUMMARY

	Price Range			Trading
	High	Low	Close	Volume
1997				
1st Quarter	\$ 1.50	\$ 1.00	\$ 1.05	652,231
2nd Quarter	1.40	0.91	1.05	359,100
3rd Quarter	1.40	0.85	0.89	277,300
4th Quarter	1.35	0.80	1.00	678,300
				1,966,931
1996				
1st Quarter	\$ 1.05	\$ 0.65	\$ 0.85	1,223,134
2nd Quarter	1.10	0.75	1.10	1,630,971
3rd Quarter	1.14	0.70	1.05	378,600
4th Quarter	1.25	0.85	1.25	742,402
				3,975,107

REAL RESOURCES INC.

Suite 700
555 Fourth Avenue S.W.
Calgary, Alberta
T2P 3E7
Telephone: [403] 262-9077
Facsimile: [403] 262-6403

1997 Annual Report